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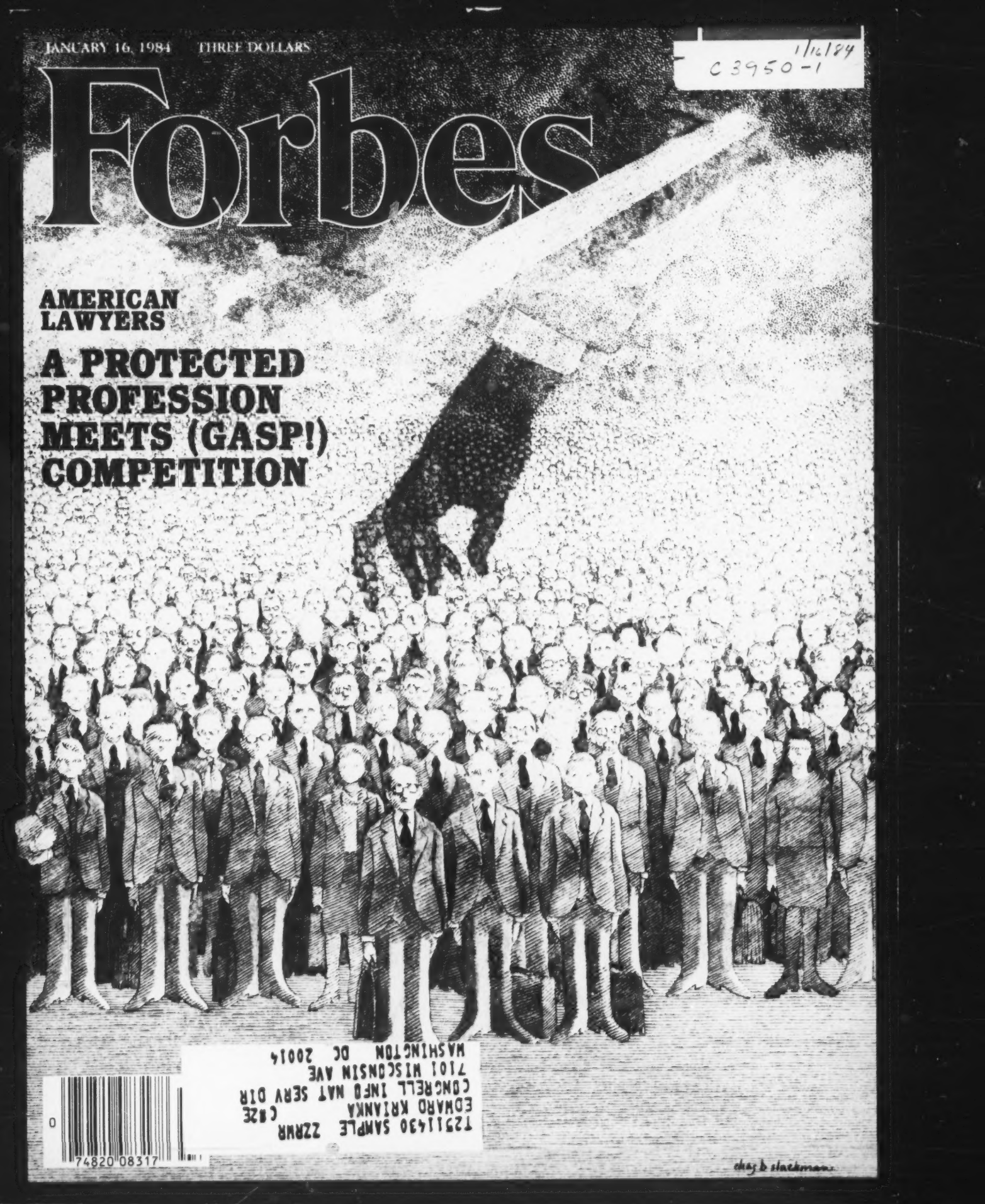
Forbes

AMERICAN LAWYERS

A PROTECTED PROFESSION MEETS (GASP!) COMPETITION



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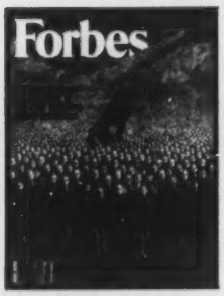

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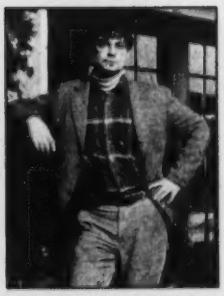

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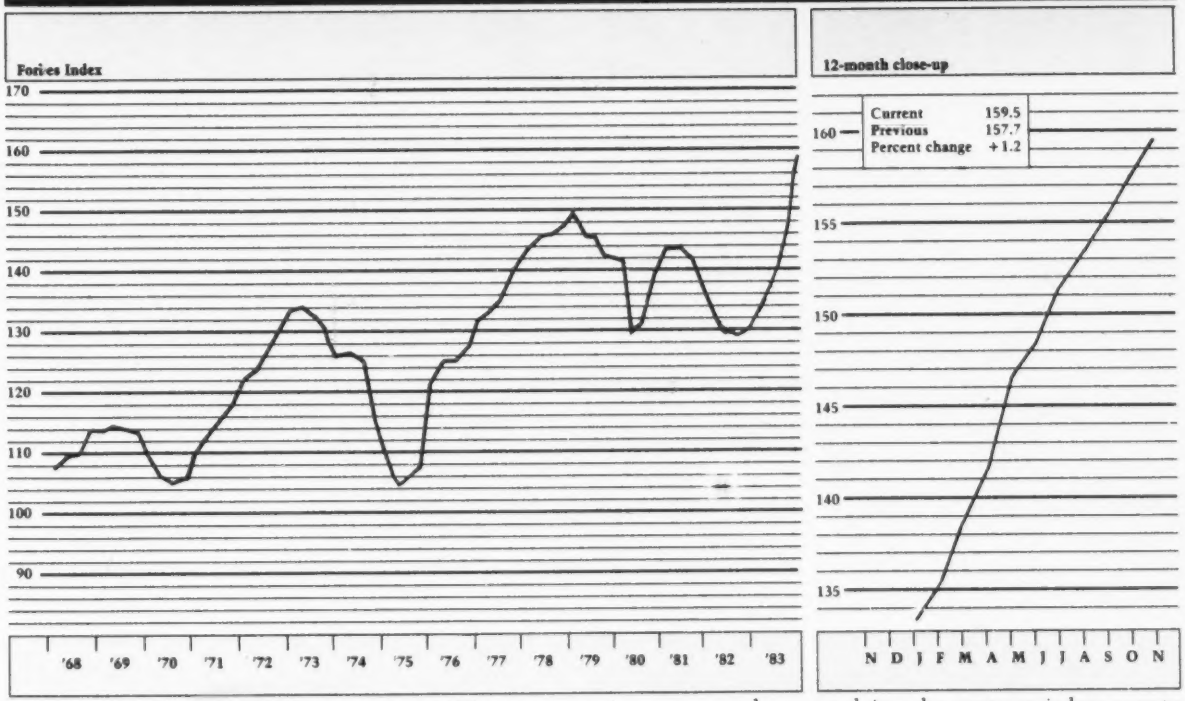
The Forbes Index



Trickling up. The Forbes Index moved up 1.2%, to a new high. But there was slippage in two components: new unemployment claims and new housing starts, which dropped 13.8% from the previous month.

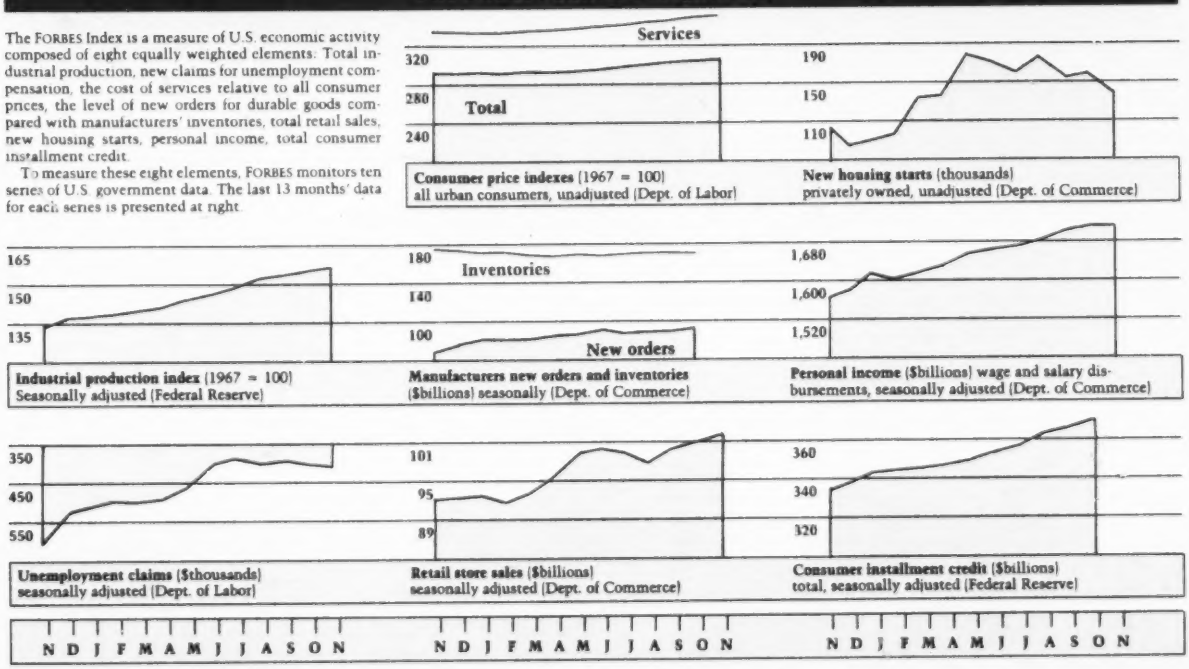
A seasonal construction falloff is normal, of course. The strength of the housing recovery can be seen by the fact that the latest monthly figures are some 25.6% higher than they were at the same time last year. The 0.4% jump in new unemployment claims, by contrast, is less easy to explain away.

The best news comes from retail sales. They were up 1.9% from the previous month and 10.8% from the same period a year ago. Industrial production gained 0.8%, and consumer installment credit rose 1.3%. While the overall consumer price index showed a monthly rise of 0.2%, personal income kept pace with a similar rise.

The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 13 months' data for each series is presented at right.



The recession may be over for most of the economy, but things are still tough in the legal profession. And they may get worse.

Lawyers versus the marketplace

By Richard Greene

IF YOU HAVE PAID any legal bills lately, you may have trouble believing what we are about to say, but it's true: Taken as a whole—and there are wondrously prosperous exceptions—American lawyers are headed for serious financial trouble. Their golden age is coming to an end. This pampered, protected profession is feeling the bite of unaccustomed competition. You won't find lawyers driving taxicabs yet, but it could happen soon.

"Competitive pressures are forcing lawyers to become businessmen," says Michael Magness, who heads the recruiting arm of law directory publisher Martindale-Hubbell. "The lawyer who doesn't become a good businessman isn't going to make it."

The public isn't yet aware of what is happening. Big-name negligence and criminal lawyers still command outrageous fees. Blue ribbon firms with blue chip clients are hardly cutting rates to stay in business. But this is a small corner of the legal world. Only the most successful lawyers earn $250,000 a year, and big corporate firms with more than 50 lawyers are just 3% of the profession.

The Commerce Department estimates that private law firms take in $30 billion annually. That sounds like a lot until you realize the money gets divided among roughly 400,000 lawyers in private practice and that the $30 billion is by no means pure gravy. After expenses, the average attorney earns probably no more than $40,000. Adjust for the fat earnings of the much publicized cream of the legal profession, and you are left with tens of thousands of lawyers who take home $30,000 a year—many a good deal less. What's more, attorneys who work for private industry typically make less than those in legal partnerships.

How does the profession earn its fees? The money is about evenly split between corporate and personal clients. On the personal side, real estate closings are a major revenue producer, along with divorce settlements and wills. For businesses, lawyers do lots of routine incorporation work and contract review.

Think of the law, and most people get visions of takeover fights, huge negligence claims and dramatic murder trials, but these account for only a tiny portion of total legal income. "You go to law school and believe you're going to conquer the world," says Ivy Adler, a 30-year-old

We're number one!

If the U.S. has lost its competitive edge in manufacturing automobiles or steel, it continues to reign supreme in turning out vast quantities of lawyers. A quick look at the chart below shows that the U.S. boasts over twice as many lawyers per thousand people as England and Wales, about five times as many as West Germany and over 25 times as many as Japan.

Lawyers per 1,000 population

England and Wales 1.00 | **Canada** 1.60 | **West Germany** 0.57 | **U.S.** 2.67 | **Japan** 0.10

New Jersey attorney. "I was very interested in the theoretical stuff, but now I do mostly house closings and partnership agreements . . . not exactly conquering the world."

Much of today's trouble stems from one simple fact: There are too many lawyers chasing too few clients. The statistics are numbing. There were only 355,000 lawyers in the U.S. in 1970. There are 622,000 now, and there will be over 1 million by the middle of the next decade.

The number of lawyers is growing much faster than the business available to support them. This should have been predictable: Lawyering is clean work, no heavy lifting and fairly prestigious. As long as it seemed lucrative, the number of people wanting to get into the profession inevitably swelled. Few people ever expected the law of supply and demand to prevail for lawyers. But it has.

The implications of all this are ominous. Ominous for the general public because some of these hungry lawyers encourage litigation—and, in the end, the general public pays for litigation. Ominous for the lawyers because, no matter how much unnecessary litigation they drum up, there isn't likely to be enough work to go around. There are simply too few fender-benders, too few divorces, too few product liability claims to keep all of today's lawyers in three-piece suits. Clearly, something has to give.

For some lawyers, it already has. Russell Howes was graduated from Wayne State University law school in 1980 expecting immediate success, the kind his older brother enjoyed in the Sixties. After applying to over 150 law firms without one offer, Howes is chastened. "The opportunities have dried up," he explains. "In any major city you're considered a golden boy if you're able to snare a job." Howes launched his own practice in a small Michigan town a couple of months ago. But this, too, is discouraging. "Someone comes through the door about every week and a half," he says.

Freshly graduated attorneys aren't the only ones with problems. According to a confidential Price Waterhouse study of law firms nationwide, net income per partner was 10% less, adjusted for inflation, in 1981 than in 1978. Meanwhile, several large firms have gone out of business. Marshall, Bratter, Greene, Allison & Tucker, a 100-lawyer New York City firm with fancy Park Avenue offices, closed its doors in 1982. So did Greenbaum, Wolff & Ernst, a specialist in the literary field. More recently, a well-known entertainment firm, Fulop & Hardee, fell apart.

Even large in-house legal staffs are feeling the pinch. One middle-aged attorney, for example, left his job as group counsel at a division of a Forbes 500s company two years ago after a corporate restructuring. With Ivy League degrees and 20 years' experience, he thought he would find a job quickly. "But I was wrong," he says today—still unemployed.

Though lawyers who have been forced into the job market know the hard truths of the mid-1980s, others hide from reality. They will tell you that the current troubles are merely a result of the recession, and that happy days are nearly here again. Or, if they admit they are worried, it is not about their own practice but about the other fellow's. Sheer self-deception. People who talk like that have their heads in the sand.

The happy days are over for lawyers not only because their numbers grew faster than the business available to them—surpluses created by supply and demand usually are eradicated by supply and demand—but also because of a phenomenon that is sweeping the economy. Lawyers, like airline pilots, bus drivers and bankers, are feeling the effects of deregulation. The difference is that lawyers got their deregulation over time, while it hit most other fields in one fell swoop.

Deregulation for lawyers dates from June 1975. At that time the Supreme Court ruled that state bar associations could no longer set minimum fees. Previously, it was pointless to shop for legal services. Lawyers could collude to fix prices. Activities that might have sent ordinary businessmen to jail were permitted for lawyers.

As the effect of this decision worked its way into the marketplace, a number of state bar associations also stopped zealously maintaining so-called unauthorized practices books. These defined activities that lawyers regarded as their exclusive province. Estate- and tax-planning, for example, were once jealously guarded. Now, says Barbara Curran of the American Bar Foundation, "state bars are not preoccupied with the gray areas." Today lawyers must compete for estate- and tax-planning business with bankers and accountants.

Lawyers have lost, too, because of such commendable reforms as no-fault insurance and no-fault divorce. But this loss of business promises to pale in the future beside what they may lose from the restructuring of financial institutions. After all, who needs a lawyer to arrange a

mortgage through his Visa card?

It's not surprising that once law firms were permitted to advertise, many did so. Nor is it surprising that so many lawyers have recently hired public relations firms—if paid advertising is undignified, what is wrong with a little free advertising?

At any rate, some 5,000 firms told the American Bar Association last year that they had tried advertising. The pitches range from agate type in legal journals to Berger & Associates' $20-off coupon in last year's New York Yellow Pages. Lawyers even buy time on television. And that's not all. Arkans & Levin, a 12-office firm based in Pennsylvania, uses matchbook covers and bowling alley scoresheets.

Law firms, even snooty Wall Street law firms, now have glossy brochures they mail to prospective clients, and partners make cold calls on corporations. All this not without a certain twinge of guilt. A press agent recently tried to persuade FORBES to interview a lawyer-client—but, please, please, don't tell anyone the client is using a flack. The interview should look spontaneous. (We turned down the suggestion.)

Once lawyers begin advertising, it's only another step to abandoning the old pretense of independent professionalism and moving toward prepaid group practice. This turns lawyers into wage earners. Horror of horrors.

Technically, group practice, which is nothing more than bringing to the law office Adam Smith's old concept of the pin factory, makes considerable sense. Many attorneys, after all, spend much of their time and make most of their money doing relatively simple, mass-producible paperwork. Your will or your mortgage probably differs little from your neighbor's, and there is no reason that it should. No reason? Well, there's the lawyers' reason. If they can charge you $800 for a fill-in-the-blanks document copied from a form book, why not?

Consider the advantages—to the public, of course, not to lawyers—of so-called prepaid law. These plans are now available to perhaps 2 million households largely as a collective bargaining fringe benefit. For as little as $50 annually, participants get a guaranteed hourly rate for legal services (usually $50). There are also free telephone consultations and low, fixed prices for wills and divorces.

Since wages have been under pressure, prepaid legal plans are on labor's back burner at the moment. But the potential is clear: An industry association study estimates that 25 million people will have such coverage by the end of the decade. This will keep a lot of lawyers from starving, but it will also deprive a lot of others of what used to be easy money.

Some hard-pressed lawyers already see prepaid plans as a source of additional income, even if it means cutting rates. Nationwide Legal Services, for example, is a sponsor of prepaid legal plans that usually require attorneys to work for $50 an hour. Now $50 an hour isn't sweatshop wages, but neither is it the stuff of Jaguars, diamonds and skiing in Switzerland.

Nonetheless, plenty of trained lawyers are happy to accept Nationwide's rates. "When we advertise for a firm to dispense services, answers pour in by the hundreds," says Lewis Burger, president of Nationwide. "Lawyers just have to understand that the days of charging $3,000 for a drunk-driving case are over."

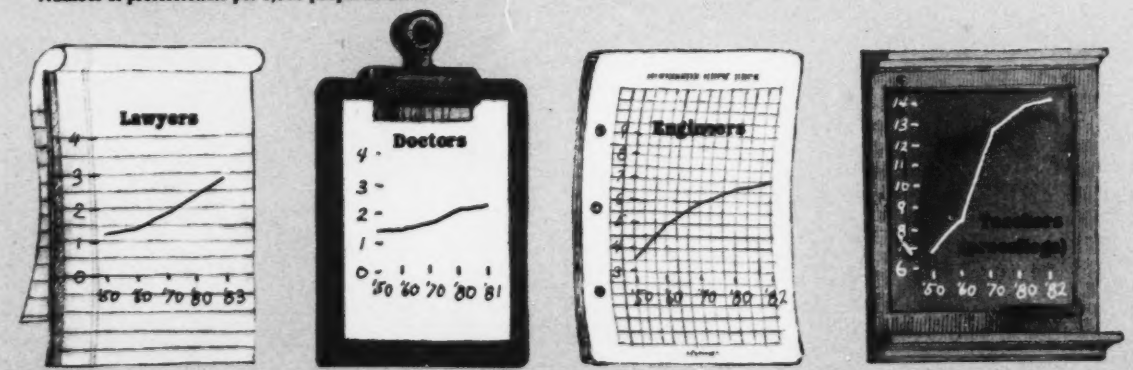
Just as they understand that, however, other businessmen see the potential of new ways to dispense legal advice. CIGNA, the $11.8 billion-a-year insurance giant, is now testing its On-Line Legal Services program in six states. Potential customers will get flyers in MasterCard or Visa bills offering unlimited free legal consultations through a toll-free telephone number. The cost: $8.75 a month. Tough cases are referred to participating local counsel, who promise 30 minutes of office time for $15 and 25% discounts for plan members.

Several other big insurers have similar plans in the works. But an even more aggressive challenge to the lawyers' status quo comes from within the profession. Legal clinics—the best-known of which are Jacoby & Meyers and Hyatt Legal Services—are as threatening to conventional law firms as off-price retailers are to Macy's and Gimbels. Well-managed production-line operations, these

Professional growth

When the number of engineers and teachers exploded during the 1950s and 1960s, those professions were hit by a classical supply-and-demand downturn. Their rapid growth rate slowed accordingly. With the legal ranks similarly swelling during the 1970s and 1980s, the same thing may soon happen again. How much longer will smart undergraduates scramble to get into law school?

Number of professionals per 1,000 people in U.S.



Sources: American Bar Foundation, American Medical Association, Bureau of Labor Statistics

off-the-rack firms offer basic legal services for a flat fee. They advertise heavily and operate out of easily accessible storefronts.

They are growing fast. Hyatt Legal Services, for example, works closely with H&R Block and now employs some 300 lawyers, ranking it among the nation's 15 largest law firms. At its present rate of growth, Hyatt claims it will be the largest law firm in America in 18 months.

Founder Joel Hyatt (J.D., Yale, 1975) considers himself more manager than lawyer. He's also a rich man at the ripe age of 33, thanks to Hyatt's success. "When I go to cocktail parties, 55-year-old lawyers invariably congratulate me and say they had the same idea 25 years ago," Hyatt says. "What they say when I walk away, I don't know."

If the old-line lawyers grumble, it isn't because these storefront lawyers are taking business away from them. More damaging to their pocketbooks is the way the Hyatts of this world are changing the way the public views legal services. They are changing it from priestly knowledge to a mere commodity bought in the marketplace. "Historically, people were intimidated to ask about legal fees, but now they know they have alternatives," says Gail Koff, partner of Jacoby & Meyers, a privately owned firm that employs about 150 lawyers.

If, say, your brother-in-law paid $300 for a will, you are less likely to accept a bill for $800 from another attorney. Ten years ago few lawyers would discuss fees with prospective clients over the telephone. But when FORBES recently called a dozen suburban New Jersey firms at random, ten gladly quoted prices for a will. And once they thought they had a prospect on the line, many firms were as eager to keep talking as insurance salesmen, mentioning other higher-profit services, like estate planning.

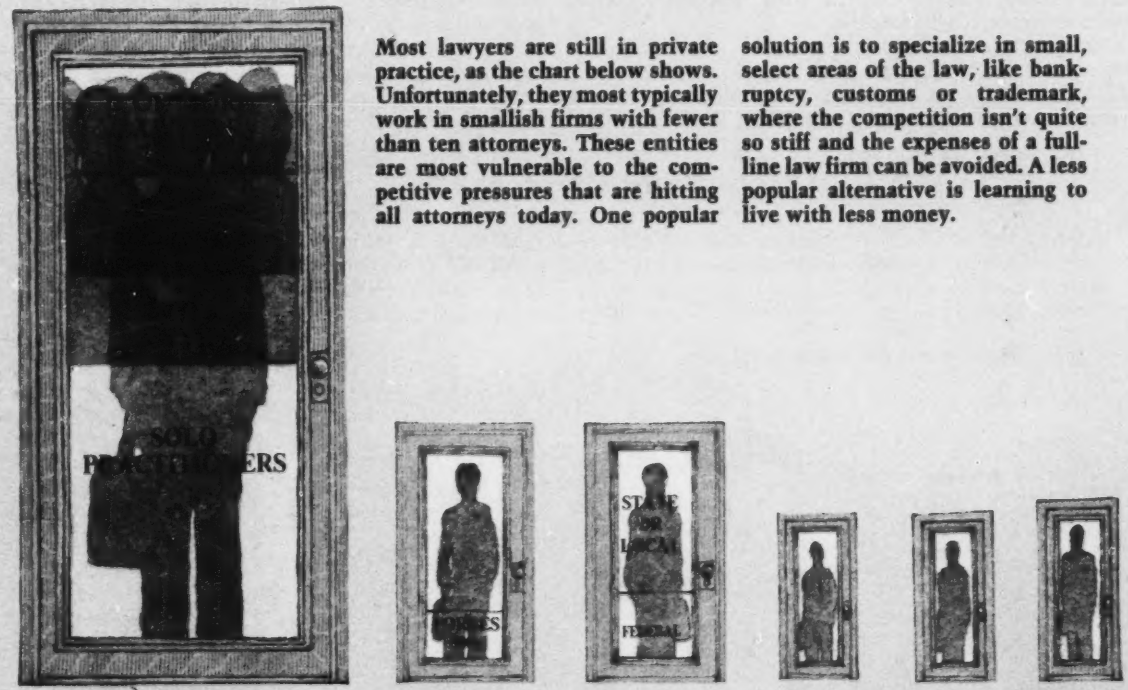
So, much of law is on its way to becoming a business like any other. This bodes ill for the 200,000 or so one-man offices. Just as the mom-and-pop grocery stores began to be crowded aside a half-century ago by supermarkets offering greater variety at better prices, so is the one-person law firm on the way out. "There was a time when the American dream was that you went out of law school, hung out your shingle, starved a few years and then started making money," says Martindale-Hubbell's Magness. "Hanging a shingle nowadays is virtually a sign of defeat. It means a guy couldn't find a job."

But surely such vulgar things aren't happening in the august field of corporate law. Oh, no? The same pressures that force firms into confrontations with their unions to keep wages down are encouraging them to whittle swollen legal bills. At many firms the cost of lawyering has outstripped R&D budgets. But lawyers, after all, rarely help produce a better product or a more profitable line. Much of their work simply helps you do things you would rather not do anyhow, like filling out government forms.

The most obvious way corporations cut legal costs is by hiring generally less expensive staff lawyers. Using them efficiently can cut legal expenses dramatically. GTE, for example, now has 117 lawyers, up from 61 in 1974. Although the growth of the in-house staff slowed during the recession, it has already hurt many outside lawyers.

Knock twice before entering

Most lawyers are still in private practice, as the chart below shows. Unfortunately, they most typically work in smallish firms with fewer than ten attorneys. These entities are most vulnerable to the competitive pressures that are hitting all attorneys today. One popular solution is to specialize in small, select areas of the law, like bankruptcy, customs or trademark, where the competition isn't quite so stiff and the expenses of a full-line law firm can be avoided. A less popular alternative is learning to live with less money.



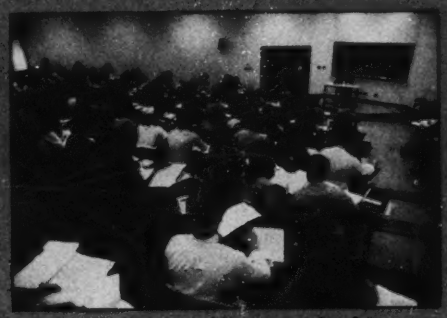
Private practice	Private industry	Government	Judiciary	Other	Inactive or retired
68%	10%	10%	4%	4%	5%

Note: Percentages add up to 101 because of rounding off.
Source: American Bar Foundation

Res ipsa loquitur

You wouldn't film *The Paper Chase* at Brooklyn Law School. There is no campus, only one box-like, ten-story building with just 14 classrooms. Nearby are a six-lane highway, municipal offices and blocks of fast food restaurants.

But never mind. Like law schools everywhere, Brooklyn has become a high-profit, high-margin business. Brooklyn, what's more, is a pure play. It is 1 of only 13 ABA-accredited U.S. institutions in business solely to sell legal education.



A lecture hall at Brooklyn Law School

Brooklyn Law's income statement is revealing. The school spends roughly $7,200 a year to turn out a lawyer. That includes building maintenance, running the library and paying about 50 professors an average of $50,000 each. With annual tuition of only $6,600 for new full-time students, there's obviously a deficit. But state aid, miscellaneous fees and the $240,000 float on tuition payments make a big difference. Add up all this extra income and it comes to about $7.6 million, roughly break-even.

There's more. Last year Brooklyn Law School earned $930,000 on its $15 million endowment, tax-free of course. With no debt or mortgage to pay—and no cash-guzzling, affiliated medical or undergraduate school to subsidize—Brooklyn simply invested its profits and geared for a bigger fundraising drive next year. Year-end operating margins, counting endowment income: 13.4%.

As law schools go, Brooklyn's figures are high. Even mighty Harvard had margins of roughly 8.5% on law school revenues of about $22 million last year, not counting another $2 million in restricted gifts.

Law schools make money because they are in a high-volume business that requires minimal capital investment. All that's necessary are some lecture halls, teachers and administrators, and a library. Compare that with a medical school, which needs costly lab equipment.

Besides tuition, which now averages $6,200 annually per student at private institutions, law schools also lean heavily on alumni for contributions. Most private schools receive gifts that amount to nearly 5% of their total operating budgets.

Brooklyn Law, of course, is already a money machine. But its fundraising now brings in an amount equal to 2.8% of operating income. Imagine what could happen if the school effectively tapped its hidden reserves—13,000 grads scattered across the U.S., including such well-heeled potential donors as artists' representative Swifty Lazar and David Liederman, owner of David's Cookies.—**Jill Andresky**

Firms are getting tougher, too, with outside counsel. "Clients say, 'We've got this matter and we've got $200,000. Do it for $200,000 or we'll go elsewhere,' " says Magness.

Needless to say, this puts pressure on the concept of hourly fees. For generations it didn't really matter how much time it took lawyers to finish a job. Within certain limits, in fact, the more time the better. Now, explains one legal consultant, "It's becoming an era of getting paid by the job as opposed to charging an hourly wage."

In the economics of law, as in all other economics, leverage is the key to profits. The leverage in law firms stems largely from keeping as many low-level associates as possible hard at work. Why? A partner who charges $120 an hour can bill perhaps 30 hours per week. But if he can keep two low-paid associates busy, billing $75 an hour for 45 hours a week, he can share in their profits as well.

This structure sometimes pushes law firms to grow too rapidly for their own good. Take a firm with 10 associates and 5 partners. Suppose seven years later 1 partner has left and 6 associates are ready to become partners. Now the firm needs 20 associates to leverage the 10 partners. Otherwise, earnings will no longer support the partners in the style to which they are accustomed.

The choice: Either mushroom in size or see profits per partner shrink. That is why partnership decisions at big firms these days are unusually bloody. One associate at a large New York City law firm, for example, considers herself lucky that her firm is simply deferring its decisions on partnership from the customary seven years as associate to eight years or nine. Regardless of when it comes, however, the truth is painful: Firms are admitting far fewer partners today than they anticipated during the ambitious hiring sprees of the mid-Seventies.

What is happening in law is, in some ways, similar to what happened on Wall Street when the commission structure was deregulated and competition became frantic. Some survived by learning how to be efficient. Consider Milbank, Tweed, Hadley & McCloy, one of the 20 largest law firms in the country, which hired Ronald Cullis, former controller of Fluor, in 1980 to be its executive director. So far, he has cut some $4 million in operating costs and set up a long-range-planning committee. Partners have responded with few complaints.

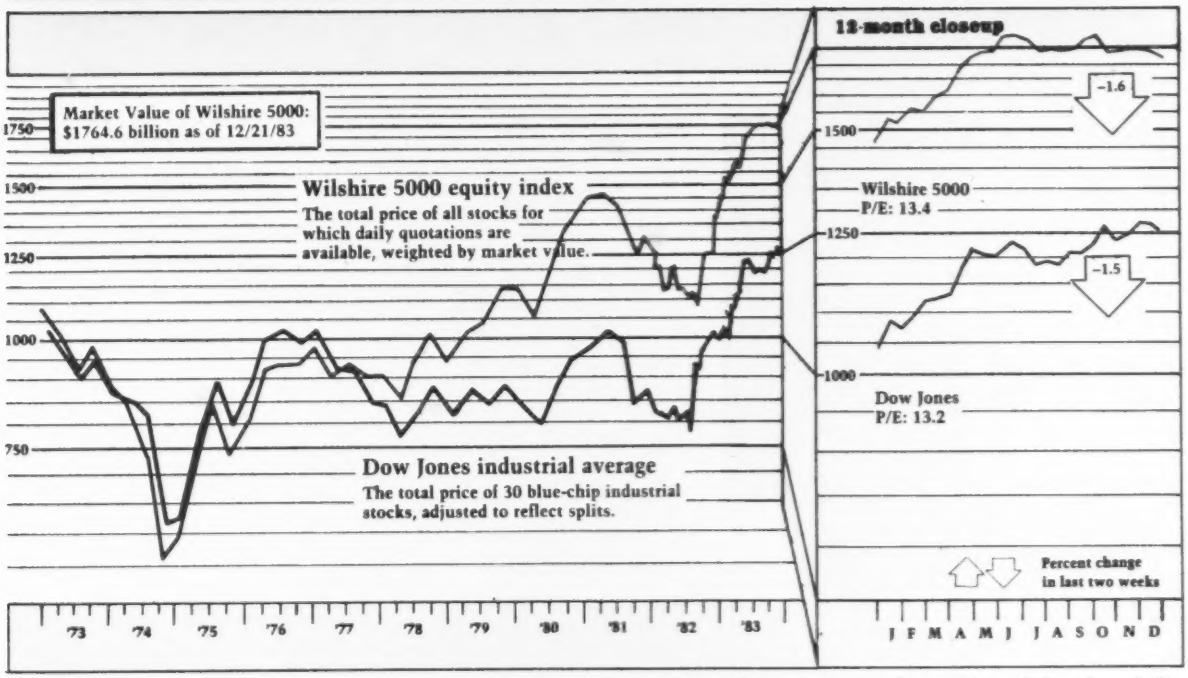
Other lawyers are taking a lead from Wall Street and doctors. They specialize, forming so-called boutique firms that deal only in bankruptcy or trademark issues. Presumably such arcane fields are less price-sensitive.

Since we have brought in the parallels with the Wall Street of a decade ago, it is only fair to point out that today's turmoil in the law will probably benefit a good many lawyers once the dust clears. The brokerage business emerged far more prosperous than before, but only after the disappearance of a good many fine, old firms, and with a good deal of blood on the floor. Giants like Merrill Lynch grew up, big outside companies like Sears and American Express moved in, and a handful of smart specialists and regionals thrived.

Similar forces could transform the legal business. Big insurers, of course, are already eyeing prepaid legal services. Aggressive legal clinics could become coast-to-coast mass marketers. And there will even be jobs for lawyers in the financial supermarket—regardless of whether American Express, Merrill Lynch or Sears owns the store.

It's the old story once again: survival of the fittest. ■

The Forbes/Wilshire 5000 Review



Playing in the snow. As cold and stormy weather swept across the nation, investors seemed to be having a good time throwing stock at one another. No one was hurt by all this fun, except for the market averages. Despite a couple of strong charges, the Dow industrials ended the most recent two-week period with a 1.5% loss. The NYSE and The Forbes 500 experienced similar setbacks. But Amex and NASDAQ issues gave up even more ground. They fell 1.9% and 2.3%, respectively.

The investor yardsticks below, however, show that high-volatility, high-P/E, high-growth and low-priced shares were clearly out of favor last month. This pattern emerges nearly every time the market slides downhill. Investors dump stocks in which they perceive high levels of risk in favor of safer investments. But electric utilities, one former haven, have recently been blemished by negative publicity about uncompleted nuclear reactors and uncertain interest rate projections.

Once again, the P/E on the Wilshire index declined. If fourth-quarter corporate earnings improve as expected, the multiple on the Wilshire will remain in the low teens only if stock prices rise. Many experts do anticipate a new year rally. But keep in mind that the market has an uncanny way of bucking the consensus.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	-2.2	-2.5	-1.6	-2.0	-1.2	-3.2
in last 52 weeks	19.3	18.0	21.2	18.2	32.5	19.3

Stock performance based on five key investor yardsticks

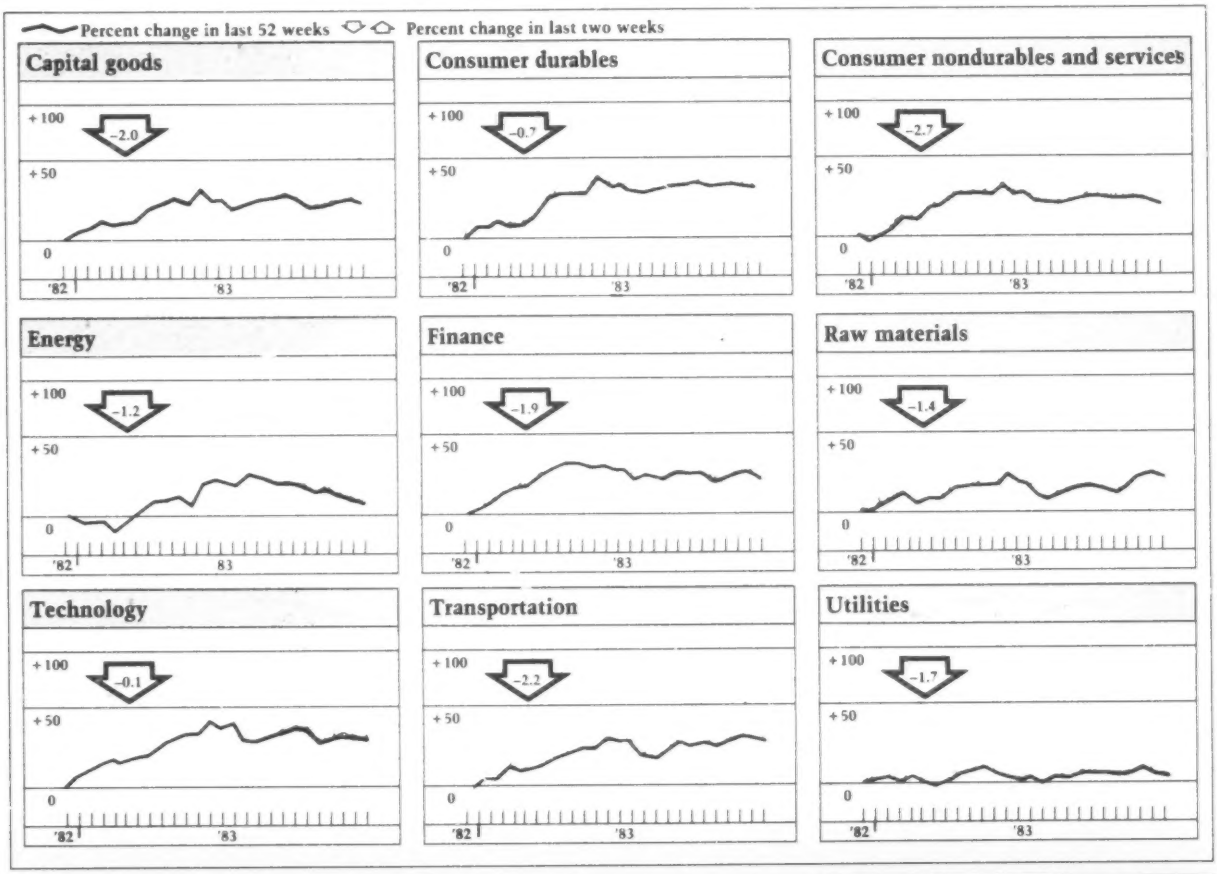
Percent change	Company size		Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	-2.2	-2.6	-3.9	-1.1	-3.6	-1.4	-1.1	-2.3	-5.2	-1.1	-0.9	-3.3
in last 52 weeks	20.8	67.0	53.3	30.6	33.9	65.5	29.3	60.0	56.8	30.7	31.2	55.1

[1]Based on sales.
[2]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.
[3]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 12/21/83. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Cutting the ropes. As year-end approached, institutions dressed up their portfolios. Investors, meanwhile, took profits on some winners and bade farewell to many losers. But most of the pressure was on the selling side, which produced two-week losses for all nine sectors. In fact, most of December was bleak for every industry sector except raw materials. This was the only group to register a gain for the four-week period. Over the two-week stretch, consumer nondurables show the biggest loss, a 2.7% decline. Although this group led the way to the August 1982 rally, it has been on a faltering course during the last several months. In fact, on a 52-week basis, consumer durables, with a 13.7% gain, is the second-poorest performing group. Only the utility sector sports a weaker record.



What The Analysts Think

Something new. Zacks Investment Research and Wilshire Associates are now providing FORBES with consensus earnings estimates for Wilshire's nine sectors and the Forbes 500. Over the last two weeks, analysts have scaled up their estimates for capital goods, consumer durables and utilities while cutting estimates for the other six groups.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	2.54	13.3
1983 estimates	3.31	11.6
1984 estimates	4.39	8.6

Rank based on change in estimate	Sector	Estimated 1984 EPS	% change in 1984 estimate in 2 weeks	in 4 weeks
1	Capital Goods	$2.13	1.55%	-2.35%
2	Consumer durables	2.70	0.91	1.28
3	Utilities	3.36	0.05	0.17
4	Consumer nondurables	2.47	-0.26	-0.55
5	Raw materials	2.82	-0.72	-0.86
6	Finance	4.05	-1.42	-1.65
7	Energy	1.93	-1.67	-1.71
8	Transportation	2.63	-1.67	1.25
9	Technology	1.63	-1.68	-1.30

Earnings projections are equal-weighted consensus estimates from over 1,800 security analysts.
These figures are compiled and updated weekly by Zacks Investment Research, a Chicago-based quantitative consulting firm.

Note: All data for periods ending 12/21/83. Prepared by Wilshire Associates, Santa Monica, Calif.; Zacks Investment Research, Inc., Chicago, Ill.